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No. 634

In the Supreme Court of the United States

OCTOBER TERM, 1931

THE TEXAS & PACIFIC RAILWAY COMPANY,
PETITIONER

v.

THE UNITED STATES

ON WRIT OF CERTIORARI TO THE COURT OF CLAIMS

BRIEF FOR THE UNITED STATES

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OPINION BELOW

The opinion of the Court of Claims (R. 13) is reported in 52 F. (2d) 1040.

JURISDICTION

The judgment sought to be reviewed was entered on October 20, 1931. (R. 17.) The petition for certiorari was filed on January 14, 1932, and the writ was granted February 15, 1932. (R. 18.) The jurisdiction of this Court rests on Section 3 (b) of the Act of February 13, 1925.

QUESTION PRESENTED

Whether a sum paid to the petitioner by the United States as the guaranty of its railway operating income for the six months period beginning March 1, 1920, pursuant to a certificate of the Interstate Commerce Commission, issued under Section 209 of the Transportation Act, 1920, was taxable income.

STATUTES INVOLVED

The statutes involved are set forth in Appendix A, *infra,* p. 19.

STATEMENT

The findings of the Court of Claims (R. 9–13) applicable to the point to which the instant petition relates may be abridged as follows:

The petitioner is a railroad corporation, and during the period of Federal control of railways was operated by the Government. (R. 9.) On March 1, 1920, the Government relinquished its control of the petitioner's properties to a receiver that was in charge of its offices. (R. 9.) The receiver operated the railroad during the six months beginning March 1, 1920. (R. 9.) The petitioner accepted the provisions of Section 209 of the Transportation Act, 1920 (*infra,* p. 19) and received for the period of six months beginning March 1, 1920, an allowance by the Interstate Commerce Commission, representing the amount necessary to make good the guaranty under Section 209, in the sum of $2,043,041.77, and one of its subsidiaries received

$18,040.86 under the same section. (R. 9.) The findings do not state when these payments were made.

The petitioner and this subsidiary filed separate returns for the year 1920. The Commissioner of Internal Revenue audited these returns and held that the subsidiary company referred to and another company were affiliated with the petitioner for 1920, and consolidated them for the purpose of the determination of their tax liability. (R. 10.) The consolidated net income of the petitioner and its subsidiaries, as finally determined by the Commissioner, included the allowances under Section 209 of the Transportation Act, 1920, which the taxpayers had not included in their original returns. The petitioner paid the amount assessed, based upon such determination, duly filed a claim for refund, and after it was rejected sued the United States in the Court of Claims. The Court of Claims decided in favor of the Government in respect of the item now in controversy.

SUMMARY OF ARGUMENT

When, on March 1, 1920, the railroads were returned to private ownership the transportation system of the country was disorganized. Most of the railroads of the United States lacked funds for necessary improvements, equipment, and expansion facilities. The credit of many carriers was seriously impaired. Congress deemed it important to preserve for the United States substantially the

whole existing transportation system. In order to do this it was thought necessary that the United States should to a certain extent finance the carriers temporarily. The provisions of Section 209 of the Transportation Act, 1920, were framed to that end.

The lines had suffered by Government regulation and by the routing of freight over competing lines which were under Federal control. The purpose of Section 209 was to reimburse railways like the petitioner's on account of a decrease in their net railway operating income because of Federal control. The legislative history shows that it was the intention of Congress to extend this aid in recognition not only of their financial necessities, but also to compensate for injury through Federal control.

The payments made under Section 209 were taxable income just as was compensation paid under the Federal Control Act. The payments were derived because of the operation of a railroad and consequently come within the definition of income as "gain derived from capital, from labor, or from both combined."

The payments here were not capital subsidies like those involved in *Edwards* v. *Cuba Railroad Company*, 268 U. S. 628.

The payments are not exempt from the income tax as "property acquired by gift." The payments made under Section 209 were based upon moral and contractual obligations. The United States received consideration for the guaranty.

Congress could hardly have contemplated that the amount paid should be exempt from income tax. Such treatment would put the railroads receiving payments under Section 209 in a better position than the roads which had no such reimbursement.

ARGUMENT

THE SUMS PAID PURSUANT TO SECTION 209 OF THE TRANSPORTATION ACT, 1920, WERE TAXABLE INCOME TO THE PETITIONER

When, on the first of March, 1920, the railroads were returned to private ownership, the transportation system of the country was disorganized. Many of the roads were in poor financial condition. Congress realized that the public welfare required the stabilization of the system, and an effort was made in the Transportation Act, 1920, to restore the carriers to a position more like that which had antedated Federal control. This Court has considered the purpose of Congress in passing these statutory provisions. In *United States* v. *Guaranty Trust Company,* 280 U. S. 478, 484, it was stated:

> These appropriations were made in order to meet a pressing need. At the time of the passage of the Transportation Act, 1920, most of the railroads of the United States lacked funds for necessary improvements, equipment, and expansion of facilities. Some of the carriers needed funds, also, to meet maturing obligations. The credit of many carriers was seriously impaired. There was a general reluctance among investors to purchase new railroad securities

even of the strongest railroads. Congress deemed it important to preserve for the nation substantially the whole existing transportation system. Compare *New England Divisions Case,* 261 U. S. 184, 190. In order to accomplish this, it was thought necessary that the United States should, to a certain extent, finance the carriers until it would become possible to restore their credit, by increase of rates or otherwise. The provisions of Title II of Transportation Act, 1920, were framed to that end.

Section 209 of the Transportation Act, 1920 (*infra,* p. 19), provided for an agreement between the United States and those carriers which were released from Federal control in 1920. Those roads which by March 15, 1920, formally accepted all the provisions of Section 209 were guaranteed for the six months beginning March 1, 1920, a minimum operating revenue as great as that received by their operation for a similar period under Federal control. In return each road agreed that if its operating revenue should prove to be greater than the agreed minimum, it would turn over the excess to the United States.

The guaranty provided by this section was a recognition by Congress of a moral obligation to the railroads that had been under Federal control. Although under the provisions of the Federal Control Act the railroads had been compensated for injury suffered by them and just compensation within the meaning of the Fifth Amendment had

been made for all legal liability of the United States, the condition of the roads as a whole was desperate. The normal competitive relationship of the transportation system of the country had been thoroughly disorganized. The operation of the properties under Federal control had been for the primary purpose of promoting the military efficiency of the country. All railway lines had been merged under the management of the Director General of Railroads into a single nation-wide system. Traffic, both passenger and freight, whether publicly or privately owned, had been routed solely in the interest of the Government. The equipment of all railroads had in effect been pooled because of the military exigency, and was scattered all over the nation. *Gulf, Mobile & Northern Railroad Co.* v. *Commissioner,* 22 B. T. A. 233, 250. (See statement of Congressman Merritt, set forth in Appendix C, *infa,* p. 27.)

The continuing effect of the disturbing influence of Federal control was obviously to be of some duration when the Transportation Act was passed in February, 1920. The compensation paid under the Federal Control Act, although adequately liquidating all actual claims for damage recognized by that Act, did not attempt to compensate for this obligation to the carriers which was definite in character but then unknown as to extent and amount.

Furthermore, one of the primary purposes of the guaranty payments was to reestablish the credit

of the railroads. This was essential for their continued successful operation, not only to enable the sale of securities for the securing of funds necessary for operations, but also for permanent and capital improvements. Many railroads that had paid dividends under private operation had not earned interest charges under Federal control. (See statement by Congressman Esch, set out in Appendix C, *infra,* p. 29.) Although the provisions of the Transportation Act, 1920, contemplated governmental aid in the refunding of debts, etc., this aid was but a partial solution of the whole problem. The necessity for rehabilitation of the credit of the railroads was imperative. The expense of operation had been materially increased. The increase in wages in 1919 was practically $1,000,000,000 and the increase in 1920 was approximately $45,000,000 additional. (See statement by Congressman Esch, set out in Appendix C, *infra,* p. 29.)

Railroad rates had not been adjusted to meet this increased expense of operation. It was contemplated that the confidence of the investing public could be restored in the railroads only by an assurance of adequate earnings. The guaranteed earnings for the six-month period immediately following the restoration of the roads to the owners was to permit roads during that period to readjust themselves to individual operation and stabilize the transportation industry in such a manner as to

reestablish their undermined and disorganized credit, resulting from Federal control.

The Board of Tax Appeals aptly summarized the situation in *Kansas City Southern Railway Company* v. *Commissioner,* 22 B. T. A. 949, 953:

> This subnormal state, resulting from the Government's use of the properties for war purposes, could not be computed in dollars but it was recognized by the Government and responsibility therefor accepted. Whether the restoration of the prewar earning capacity of the railroads that had been under Government control was a legal obligation enforceable at law under the terms of the "standard contract" has never been decided by the courts because, in the postwar railway crisis, the Congress promptly conceded the responsibility of the Republic and settled a recognized obligation without requiring the carriers to resort to litigation.
>
> In the circumstances disclosed by the record and in the light of historical events within common knowledge, we conclude that the payment in question was in recognition of an obligation assumed by the Government when it temporarily sequestered the petitioner's railroad for war purposes.

Thus the payments under Section 209 of the Transportation Act, 1920 (*infra,* pp. 19–24) were in recognition of at least a moral obligation. We contend that they constituted income within the mean-

ing of the Sixteenth Amendment, as interpreted by this Court.

Furthermore, the obligations of the United States and the railroad under Section 209 were mutual and contractual. The road was entitled to no benefit under the statute until it accepted all the provisions of the section. Such an acceptance included a promise to pay the Government any excess of railway operating income over the minimum fixed by the statute. Whether or not the road would have to pay something to the Treasury under this provision could not definitely be determined by March 15, 1920, when the acceptance was required. The possibility of such payment depended upon the earnings of the road during the next six months. As the court below said (R. 14.):

> This constituted a contractual agreement between the carrier and the Government, and it could not be ascertained until an accounting had been had whether the Government would pay the railroad or whether the railroad would pay the Government. This feature of the case takes away any basis for holding that the payments by the Government were pure gifts or subsidies to the railroads.

It is true that the Government paid out substantially more under this provision of the Act than it received, but the obligations which any railroad incurred by accepting the provisions of the section were genuine and real. Over two million dollars

was collected by the United States under this provision. (See letter from the Interstate Commerce Commission, set forth in Appendix B, *infra,* p. 25.) The assumption of such obligations constituted a substantial consideration for the promise of Congress to guarantee a minimum operating income for the railroads. This was the opinion of the District Court for the Eastern District of South Carolina in *United States* v. *Hampton & Branchville Railroad Company,* not reported, when in a suit to recover excess revenue from a carrier the Government's motion for a directed verdict was granted in the following language (p. 81 of trial proceedings):

> As I view it, the Commission was authorized by the contract between the parties. All of these statutory provisions were embodied in this contract, and by the agreement of the parties they became a part of the contract, and by that contract the Commission was to fix the operating expense, and the maintenance of equipment, and the maintenance for right of way, and they did that on the books of the Company, and on data that they found there, and they certified the amount that is due, * * *.

We submit that the payments in this case were made pursuant to contract and hence are taxable income. The fact that the carriers' promise furnished consideration for the Government's payment was relied upon in the numerous decisions by the Board of Tax Appeals which have held that such

payments should be included in gross income. *Gulf, Mobile & Northern Railroad* v. *Commissioner,* 22 B. T. A. 233, 247; *Missouri Pacific Railroad Co.* v. *Commissioner,* 22 B. T. A. 267; *Kansas City Southern Railway Co.* v. *Commissioner,* 22 B. T. A. 949; *Galveston Wharf Co.* v. *Commissioner,* 22 B. T. A. 1312; *Chicago & Northwestern Railway Co.* v. *Commissioner,* 22 B. T. A. 1407; *International-Great Northern Railroad Co.* v. *Commissioner,* 24 B. T. A. 726, 739. There is no authority to the contrary.

The petitioner contends that this payment under Section 209 was not "income," and stresses the definition of income as "gain derived from capital, from labor, or from both combined." See *Eisner* v. *Macomber,* 252 U. S. 189, 207. But, accepting that definition, we submit it clearly includes gain such as the petitioner received by this reimbursement. There is no doubt that compensation paid under the Federal Control Act is taxable income. *Kansas City Southern Railway Co.* v. *Commissioner,* 52 F. (2d) 372, 379 (C. C. A. 8th), certiorari denied, 284 U. S. (Part 2) viii; *Gulf, Mobile & Northern Railroad Co.* v. *Commissioner,* 22 B. T. A. 233, 239. The purpose of the payment involved in the instant case was similar. The form of payment is not significant.

In *Hamilton* v. *Kentucky & Indiana Terminal R. Co.,* 289 Fed. 20 (C. C. A. 6th), it was held that payments by railroad companies to reimburse their subsidiary terminal company the amount of the latter's operating deficit were to be included in gross

income under the Revenue Act of 1917. In the instant case the payments were derived because of the operation of a railroad. Nothing was to be paid under Section 209 unless the railroad had been in active operation. Had the carrier's business been profitable, its earnings would clearly have constituted income. The amount of the payment by the Government depended upon the amount of the road's earnings, and took the place of operating income. The gain was derived from the road's operation just as much as if the money had been received from shippers in the form of freight rates instead of from the United States. This was pointed out by the Board of Tax Appeals in *Gulf, Mobile & Northern Railroad Co.* v. *Commissioner,* 22 B. T. A. 233, at 254, where identical payments were held taxable:

> It is contended by the petitioner that the payments did not come within the scope of this definition. The payments by the Government, however, were dependent upon the operation of the railroad, that is, the use of both capital and labor. The payments were not received for the guaranty period unless the railroads were in operation during that period, and then only in the event that their operating income was less than the guaranteed amount, and we can not overlook the fact that it was railway operating income which was guaranteed and made up. The Government derived a substantial benefit from the payments. It received consideration from the substantial good obtained for or expected to be obtained for the peo-

> ple as a whole on account of the more efficient operation of the railroads and the further establishment of their credit.

Petitioner also contends that the payments were capital subsidies and relies upon *Edwards* v. *Cuba Railroad Company*, 268 U. S. 628. There this Court said (pp. 632–633) that the facts indicated that—

> The subsidy payments were proportionate to mileage completed; and this indicates a purpose to reimburse plaintiff for capital expenditures. * * * Neither the laws nor the contracts indicate that the money subsidies were to be used for the payment of dividends, interest or anything else properly chargeable to or payable out of earnings or income. The subsidy payments taxed were not made for services rendered or to be rendered.

In the instant case, the payments were expressly a reimbursement of lost operating income and are not analogous to the capital subsidy involved in the *Cuba Railroad* case. There were no restrictions expressed or implied on the use by the railroads of the funds paid under Section 209. As previously indicated, the moneys were paid in recognition of an existing obligation. Although the obligation was perhaps not legally enforceable, it was of a nature that appealed to Congress as compelling and unavoidable, and Congress recognized it by passing the statute. The obligation arose from diminished operating revenue, rather than from impaired capital investments. In a case identical

with the instant one, *Kansas City Southern Railway Co.* v. *Commissioner,* 22 B. T. A. 949, 951, the Board of Tax Appeals characterized the nature of these payments with these words:

> The petitioner received the guaranty payment free from limitations or restrictions and from the date of such receipt it was available for all corporate purposes to which income may be applied. It could be used for the payment of dividends or operating expense, or it could be invested in capital additions.
>
> This is in sharp contrast with the single use which could be made of the subsidy in the *Cuba* case, which we think is in no wise controlling in the circumstances herein.

The nontaxability of these payments under Section 209 would be inconsistent with the purpose of Congress in enacting that statute. Congress desired to restore the competitive balance of the railroads which had existed prior to Federal control. It was sought to strengthen the carriers that had been injured by Federal control so that they would again be competitors in the transportation business. There was no purpose to place these weaker roads which Congress was reimbursing in a better position than the stronger carriers which showed no decrease in operating revenue in order to secure compensation. Yet that is exactly what would happen if these payments should be held tax exempt.

Thus, assume that railroads A and B are each guaranteed a $750,000 revenue under Section 209. During the guaranty period, carrier A earns the $750,000, but B has no railway operating income. A payment of $750,000 is made to railroad B. Road A is, of course, taxed upon its $750,000 operating revenue. But carrier B receives a Government payment of $750,000 tax free, and as a result is better situated financially than its competitor. Such an unreasonable result could hardly have been intended by Congress in passing Section 209.

The petitioner further contends that these payments were *gratuities*. The Government maintains that in exempting from gross income "the value of property acquired by gift" in Section 213 (b) (3) of the Revenue Act of 1918, Congress had no intention of rendering nontaxable the payment received by the petitioner in the instant case. Furthermore, as has been pointed out, the carriers gave consideration for the payments.

Even if there were no legal consideration for the payment, that would not make the payment a gift. Many decisions have held taxable payments made by corporations to officers as compensation for past services which had already been fully paid for. *Noel* v. *Parrott*, 15 F. (2d) 669 (C. C. A. 4th), certiorari denied, 273 U. S. 754; *Schumacher* v. *United States*, (C. Cls.) decided February 8, 1932, reported in 1932 Prentice-Hall Federal Tax Service at Paragraph 795. In the instant case Congress felt obligated to reimburse the railroads and the

mere fact that until the statute was enacted the carriers had no cause of action in a court of law does not render the payment a gratuity. In *Williams* v. *Heard*, 140 U. S. 529, in speaking of the awards by the Court of Commissioners of Alabama Claims, where there was no legally enforceable obligation prior to the statute, this Court said (p. 541):

> Neither do we think that the money appropriated by Congress by the act of 1882 to pay these claims should be considered merely as a gratuity.

CONCLUSION

The decision below is correct. No court has decided the question otherwise. The judgment of the Court of Claims should be affirmed.

Respectfully submitted.

THOMAS D. THACHER,
Solicitor General.
CHARLES B. RUGG,
Assistant Attorney General.
JOSEPH H. SHEPPARD,
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ERWIN N. GRISWOLD,
Attorneys.

APRIL, 1932.

APPENDIX A

STATUTES INVOLVED

Section 213 of the Revenue Act of 1918, c. 18, 40 Stat. 1057, 1065, provides in part:

> SEC. 213. That for the purposes of this title (except as otherwise provided in section 233) the term "gross income"—
>
> * * * * *
>
> (b) Does not include the following items, which shall be exempt from taxation under this title:
>
> * * * * *
>
> (3) The value of property acquired by gift, * * *

Section 209 of the Transportation Act of 1920, c. 91, 41 Stat. 456, 464, U. S. C., Title 49, Section 77, provides in part:

> SEC. 209. (a) When used in this section—
>
> The term "carrier" means (1) a carrier by railroad or partly by railroad and partly by water, whose railroad or system of transportation is under Federal control at the time Federal control terminates, or which has heretofore engaged as a common carrier in general transportation and competed for traffic, or connected, with a railroad at any time under Federal control; and (2) a sleeping car company whose system of transportation is under Federal control at the time

Federal control terminates; but does not include a street or interurban electric railway not under Federal control at the time Federal control terminates, which has as its principal source of operating revenue urban, suburban, or interurban passenger traffic or sale of power, heat, and light, or both;

The term "guaranty period" means the six months beginning March 1, 1920;

The term "test period" means the three years ending June 30, 1917; and

The term "railway operating income" and other references to accounts of carriers by railroad shall, in the case of a sleeping-car company, be construed as indicating the appropriate corresponding accounts in the accounting system prescribed by the Commission.

(b) This section shall not be applicable to any carrier which does not on or before March 15, 1920, file with the Commission a written statement that it accepts all the provisions of this section.

(c) The United States hereby guarantees—

(1) With respect to any carrier with which a contract (exclusive of so-called co-operative contracts or waivers) has been made fixing the amount of just compensation under the Federal Control Act, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than one-half the amount named in such contract as annual compensation, or, where the contract fixed a lump sum as compensation for the whole period of Federal operation, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than an amount which shall bear the same proportion to the lump sum so fixed as six months bears to the number

of months during which such carrier was under Federal operation, including in both cases the increases in such compensation provided for in section 4 of the Federal Control Act;

(2) With respect to any carrier entitled to just compensation under the Federal Control Act, with which such a contract has not been made, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than one-half of the annual amount estimated by the President as just compensation for such carrier under the Federal Control Act, including the increases in such compensation provided for in section 4 of the Federal Control Act. If any such carrier does not accept the President's estimate respecting its just compensation, and if in proceedings under section 3 of the Federal Control Act it is determined that a larger or smaller annual amount is due as just compensation, the guaranty under this paragraph shall be increased or decreased accordingly;

(3) With respect to any carrier, whether or not entitled to just compensation under the Federal Control Act, with which such a contract has not been made, and for which no estimate of just compensation is made by the President, and which for the test period as a whole sustained a deficit in railway operating income, the guaranty shall be a sum equal to (a) the amount by which any deficit in its railway operating income for the guaranty period as a whole exceeds one-half of its average annual deficit in railway operating income for the test period, plus (b) an amount equal to one-half the annual sum fixed by the President under section 4 of the Federal Control Act;

(4) With respect to any carrier not entitled to just compensation under the Federal Control Act, which for the test period as a whole had an average annual railway operating income, that the railway operating income of such carrier for the guaranty period as a whole shall not be less than one-half the average annual railway operating income of such carrier during the test period.

(d) If for the guaranty period as a whole the railway operating income of any carrier entitled to a guaranty under paragraph (1), (2), or (4) of subdivision (c) is in excess of the minimum railway operating income guaranteed in such paragraph, such carrier shall forthwith pay the amount of such excess into the Treasury of the United States. If for the guaranty period as a whole the railway operating income of any carrier entitled to a guaranty under paragraph (3) of subdivision (c) is in excess of one-half of the annual sum fixed by the President with respect to such carrier under section 4 of the Federal Control Act, such carrier shall forthwith pay the amount of such excess into the Treasury of the United States. The amounts so paid into the Treasury of the United States shall be added to the funds made available under section 202 for the purposes indicated in such section. Notwithstanding the provisions of this subdivision, any carrier may retain out of any such excess any amount necessary to enable it to pay its fixed charges accruing during the guaranty period.

(e) For the purposes of this section railway operating income, or any deficit therein, for the test period shall be computed in the manner provided for in section 1 of the Federal Control Act.

(f) In computing railway operating income, or any deficit therein, for the guaranty period for the purposes of this section—

(1) Debits and credits arising from the accounts, called in the monthly reports to the Commission equipment rents and joint facility rents, shall be included, but debits and credits arising from the operation of such street electric passenger railways, including railways commonly called interurbans, as are not under Federal control at the time of termination thereof, shall be excluded;

(2) Proper adjustments shall be made (a) in case any lines which were, during any portion of the period of Federal control, a part of the railroad or system of transportation of the carrier, and whose railway operating income was included in such income of the carrier for the test period, do not continue to be a part of such railroad or system of transportation during the entire guaranty period, and (b) in case of any lines acquired by, leased to, or consolidated with, the railroad or system of transportation of the carrier at any time since the end of the test period and prior to the expiration of the guaranty period, for which separate operating returns to the Commission are not made in respect to the entire portion of the guaranty period;

(3) There shall not be included in operating expenses, for maintenance of way and structures, or for maintenance of equipment, more than an amount fixed by the Commission. In fixing such amount the Commission shall so far as practicable apply the rule set forth in the proviso in paragraph (a) of section 5 of the "standard contract" between the United States and the carriers (whether or not such contract has been entered into

with the carrier whose railway operating income is being computed);

(4) There shall not be included any taxes paid under Title I or II of the Revenue Act of 1917, or such portion of the taxes paid under Title II or III of the Revenue Act of 1918 as by the terms of such Act are to be treated as levied by an Act in amendment of Title I or II of the Revenue Act of 1917; and

(5) The Commission shall require the elimination and restatement of the operating expenses and revenues (other than for maintenance of way and structures, or maintenance of equipment) for the guaranty period, to the extent necessary to correct and exclude any disproportionate or unreasonable charge to such expenses or revenues for such period, or any charge to such expenses or revenues for such period which under a proper system of accounting is attributable to another period.

(g) The Commission shall, as soon as practicable after the expiration of the guaranty period, ascertain and certify to the Secretary of the Treasury the several amounts necessary to make good the foregoing guaranty to each carrier. The Secretary of the Treasury is hereby authorized and directed thereupon to draw warrants in favor of each such carrier upon the Treasury of the United States, for the amount shown in such certificate as necessary to make good such guaranty. An amount sufficient to pay such warrants is hereby appropriated out of any money in the Treasury not otherwise appropriated.

* * * * *

APPENDIX B

INTERSTATE COMMERCE COMMISSION,
OFFICE OF THE SECRETARY,
Washington, March 5, 1932.

George B. McGinty, Secretary. Finance Docket No. 834

The Honorable CHARLES B. RUGG,
Assistant Attorney General,
Washington, D. C.

DEAR SIR: Acknowledgment is made of your letter of the 2d instant, initials JHS, in re: *Texas & Pacific Railway Co.* v. *U. S., Sup. Ct.* No. 634. In response to your request for certain information I attach hereto a statement showing the names of all carriers and the amounts earned by each in the guaranty period in excess of the test period income and therefore subject to the provisions of subdivision (d) of section 209 of the transportation act, 1920. This statement also shows citation of the Commission's reports covering these cases.

This statement has been compiled to show the carriers having an independent status with excess income of $452,833.38 and those included in group or system settlements which reduced the amounts otherwise payable in the aggregate amount of $2,358,023.52, a total excess income of $2,810,856.90.

The net amount certified to the Treasury as due railroads under the provisions of the above-mentioned Act in settlement to date of 523 claims is

$528,985,521.20. This latter figure is inclusive of the amount of $2,810,856.90, shown above as due from certain railroads.

Very truly yours,

G. B. McGINTY, *Secretary.*

Enclosure.

Statement showing carriers which have been certified to the Secretary of the Treasury under the provisions of section 209 of the transportation act, 1920, as having earned an income in the guaranty period in excess of the income earned in the test period.

Independent carriers	F. D.	Excess income in guaranty period	Citation
Ahnapee & Western	252	$2,940.39	76 I. C. C. 660.
Barre & Chelsea	301	28,391.33	79 I. C. C. 343.
Campbell's Creek	334	3,560.52	86 I. C. C. 695.
Carolina R. R	336	910.78	82 I. C. C. 173.
E. Tennessee & W. No. Carolina	451	10,473.42	79 I. C. C. 52.
Gilmore & Pittsburg	489	1,427.11	99 I. C. C. 247.
Hampton & Branchville	514	4,768.46	117 I. C. C. 341.
Ironton R. R	541	1,935.77	79 I. C. C. 455.
Kewaunee Green Bay & West	563	260.50	76 I. C. C. 699.
Kishacoquillas Ry	565	2,707.79	82 I. C. C. 565.
Lake Tahoe Ry. & Transp	574	5,694.23	76 I. C. C. 537.
Louisiana Western	596	168,397.58	79 I. C. C. 401.
Massena Terminal	616	7,399.44	79 I. C. C. 525.
Missouri & Illinois Bdg. & Belt	644	20,395.56	90 I. C. C. 633.
Rosslyn Connecting	774	5,677.03	90 I. C. C. 747.
Sandy Valley & Elkhorn	780	189,944.79	99 I. C. C. 236.
South Manchester	795	1,079.16	82 I. C. C. 167.
Yreka R. R	915	562.52	99 I. C. C. 760.
Total		452,833.38	
INCLUDED IN SYSTEM SETTLEMENT			
Beaumont Sour Lake & Wes	306	71,242.62	82 I. C. C. 513.
Lake George Steamboat Co	572	10,986.32	94 I. C. C. 253.
Los Angeles & Salt Lake	592	326,330.34	82 I. C. C. 486.
Louisiana & Miss. River Trans	593	3,065.10	86 I. C. C. 3.
Union Pacific	855	1,946,399.14	82 I. C. C. 486.
Total		2,358,023.52	
Grand total		2,810,856.90	

APPENDIX C

EXCERPTS FROM CONGRESSIONAL RECORD

Remarks by Mr. Merritt, of the Commerce Committee, reported in Vol. 58 of the Congressional Record, page 8342:

> The conditions are that these roads, not by their own desire but by the exigency of war and by the operation of law, were taken over by the United States and had been run by the United States for about two years. I do not say this by way of criticism, but the fact is that the operation of the railroads by the United States has produced a great deficit. There is a continuing deficit to-day. The personnel of the roads has been disturbed. The property of the roads, in the shape of cars, is all over the United States, and it will take a large amount of time and a great amount of expense for each road to get its property together, to get its personnel together, and to go on running as a separate entity.
>
> That is the reason why the committee has allowed this period of six months under the present guaranty, so that the roads may get new rates before the commission, and get their business started under these new rates, so that when the guaranty ends they may be on their own feet and may go on in a self-supporting way.

Remarks by Mr. Esch, for the Commerce Committee, of the 66th Congress, reported in the Congressional Record, Volume 58, page 8453:

Mr. Chairman, the necessity for maintaining the guaranty for a period of six months must be evident to everyone who realizes the tremendous increase in cost of the operation imposed on the carriers, as was suggested by the gentleman from Vermont, by fiat. The railroads did not have anything to say about the amount or as to the cost of material. That was fixed by governmental agency. The total increase of wages in 1919 through Government agency was practically $1,000,000,000. The increase this year will possibly be larger than that by reason of the fact that the shopmen have recently had an increase granted through the Director General, retroactive to the 1st of May, which will increase the wage scale $45,000,000 per annum.

Now, under these circumstances we felt that we were obligated to maintain this standard return for a period of six months until such time as the Interstate Commerce Commission could adjust the level of rates to meet the increased cost. We are paying the deficit which has occurred under Federal control. We hope that when the roads are returned through the standard return guaranty of six months the commission will adjust the level of rates so as to permit the roads to stand alone. That is why we are putting in the guaranty.

Remarks by Mr. Esch, for the conference committee of the 66th Congress, reported in the Congressional Record, volume 59, page 3268:

But the question will be raised why we should guarantee at all. When Federal control ceases why not have the guaranty of the Government for a standard return also cease? The reason lies in the financial straits

of the carriers when Federal control shall cease.

What is the situation? Prior to the war 60.38 per cent of the roads of class 1 earned a dividend and paid their interest. The balance did not. During the period of Federal control only 57 of the 175 class 1 roads earned their interest and only a few paid dividends. One hundred and eight of them did not earn their interest, and, of course, could not pay dividends, and many did not earn their operating expenses.

With this situation confronting the carriers on the 1st day of March, the committee of conference indorsed the attitude of both Senate and House, continuing the guaranty in the House bill for a straight term of six months.

In 1919, 108 class 1 roads lacked $60,000,000 of earning their interest and fixed charges. The net operating income last year was only practically half of the standard return which we guaranteed. Should we thrust these roads on their own resources on the 1st of March without a guaranty, I make the prediction that within three months 50 per cent of them would go into receiverships. Do we want to do that? Ought we to do it? No; because receiverships for railroads means receiverships for industrial plants and all classes of business throughout the country.

U. S. GOVERNMENT PRINTING OFFICE: 1920

SUPREME COURT OF THE UNITED STATES.

No. 634.—October Term, 1931.

The Texas & Pacific Railway Company, Petitioner, *vs.* The United States. } On Writ of Certiorari to the Court of Claims.

[May 16, 1932.]

Mr. Justice Roberts delivered the opinion of the Court.

During federal control of railways that of petitioner was operated by the Director General under the act of March 21, 1918.[1] Pursuant to the Transportation Act, 1920,[2] the Government relinquished the property March 1, 1920; petitioner accepted the provisions of § 209[3] of the act, and consequently received for the six months period commencing March 1, 1920, an allowance awarded by the Interstate Commerce Commission to make good the guaranty embodied in that section. The company omitted this sum from taxable income returned for the year 1920. After audit the Commissioner of Internal Revenue added the amount to the petitioner's income and assessed a resulting additional tax, which was paid under protest. Upon rejection of a claim for refund, suit was brought in the Court of Claims to recover the portion of the tax attributable to the inclusion of the guaranty payment, petitioner asserting that the amount received was a subsidy or gift and therefore not income within the Sixteenth Amendment of the Constitution or § 213 of the Revenue Act of 1918.[4] Recovery was denied. This court granted certiorari.

[1] Ch. 25, 40 Stat. 451.

[2] Act of February 28, 1920, c. 91, 41 Stat. 456.

[3] 41 Stat. 464; U. S. C., Tit. 49, § 77.

[4] 40 Stat. 1057, 1065. "That for the purposes of this title . . . the term 'gross income' . . . (b) Does not include . . . (3) The value of property acquired by gift" . . .

By the terms of § 209 of the Transportation Act railroad companies which, like petitioner, had made contracts with the Director General for annual compensation during federal control, were guaranteed an operating income for the ensuing six months of not less than one-half the amount of such compensation. A minimum operating revenue was also assured to carriers not having such contracts, which had been under federal control or adversely affected thereby. Payment was conditioned on the carrier's acceptance of the provisions of the section, one of which was the agreement that if operating revenue for the period should exceed the guaranteed amount the excess should be paid into the Treasury. Petitioner signified its acceptance.

The statute in terms guarantees a "*minimum operating income*" for six months after relinquishment of federal control. The situation in which the railroads of the country were as a result of war-time Government operation is well described in *United States* v. *Guaranty Trust Company*, 280 U. S. 478, 484. During that period their expenses had risen and there had been no commensurate increase in rates. While the Government had either paid or was obligated to pay just compensation for their requisition, the amount of it was known to be insufficient for rehabilitation of the roads as privately owned and operated organizations. Until rates could be adjusted to meet increased expenses, loans be negotiated, and operating forces realigned and reintegrated, the credit of the carriers must by some means be re-established. Thus the Government had a real obligation, not readily susceptible of accurate measurement, to assist in the restoration of normal conditions. The purpose of the guaranty provision was to stabilize the credit position of the roads by assuring them a minimum operating income. They were bound to operate their properties in order to avail themselves of the Government's proffer. Under the terms of the statute no sum could be received save as a result of operation. If the fruits of the employment of a road's capital and labor should fall below a fixed minimum then the Government agreed to make up the deficiency, and if the income were to exceed that minimum the carrier bound itself to pay the excess into the federal treasury. In the latter event the carrier unquestionably would have been obligated to pay income tax measured by actual earnings; in the former, it ought not to be in a

better position than if it had earned the specified minimum. Clearly, then, the amount paid to bring the yield from operation up to the required minimum was as much income from operation as were the railroad's receipts from fares and charges.

The sums received under the act were not subsidies or gifts,—that is, contributions to the capital of the railroads,—and this fact distinguishes cases such as *Edwards* v. *Cuba Railroad Co.*, 268 U. S. 628, where the payments were conditioned upon construction work performed. Here they were to be measured by a deficiency in operating income, and might be used for the payment of dividends, of operating expenses, of capital charges, or for any other purpose within the corporate authority, just as any other operating revenue might be applied. The Government's payments were not in their nature bounties, but an addition to a depleted operating revenue consequent upon a federal activity.

In a proper sense these payments constituted income to the carrier not exempt from taxation under the Sixteenth Amendment or the Revenue Act of 1918. The Court of Claims was right in denying the claim and the judgment must be

Affirmed.

A true copy.

Test:

Clerk, Supreme Court, U. S.